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IN THE

Supreme Court of the United States

HARTFORD ACCIDENT & INDEMNITY COMPANY,
Appellant

vs.

O. L. BUNN, doing business as BUNN ELECTRIC COMPANY, et al,
Appellees

No. 333

OCTOBER TERM, 1931

BRIEF FOR APPELLANT

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STATUTE CITED

Chap. 128 Mississippi Laws of 1918.
Hemmingways Code of Mississippi S.2598.

IN THE

Supreme Court of the United States

HARTFORD ACCIDENT & INDEMNITY COMPANY,
Appellant

vs.

O. L. BUNN, doing business as BUNN ELECTRIC COMPANY, et al,
Appellees

No. 333

OCTOBER TERM, 1931

Appeal from the Supreme Court of Mississippi

BRIEF FOR APPELLANT

The first opinion of the court below is found in 155 Miss. 31 (119 So. 366). Subsequent opinions are not yet officially reported, but are to be found in 132 So. 535 and 135 So. 497.

STATEMENT OF THE CASE

The case involves solely the constitutionality of a statute of Mississippi (Chapter 128, Laws of 1918, State of Mississippi; Hemmingway's Code § 2598).

A full copy of the statute is set out in an appendix hereto.

Briefly, the parts of the statute material here may be summarized as follows:

Section 1 gives to a materialman (and as used herein the word "materialman" will include subcontractors and laborers, as well as materialmen in the strict sense) who have not been paid by a contractor engaged in private construction, the right to give the landowner notice of their claims and thereby bind the funds due by the landowner to the contractor, and creates a lien in their favor accordingly.

Section 2 prohibits a contractor from assigning the contract or the proceeds thereof, with a proviso that this section shall not apply if the bond provided for in section 3 be given.

Section 3 (the section which is the subject of the constitutional attack herein) provides:

> "That when any contractor or subcontractor entering into a formal contract with any person, firm or corporation, for the construction of any building or work or the doing of any repairs, shall enter into a bond with such person, firm or corporation guaranteeing the faithful performance of such contract and containing such provisions and penalties as the parties thereto may insert therein, such bond shall also be subject to the additional obligations that such contractor or subcontractor, shall promptly make payments to all persons furnishing labor or material under said contract; and in the event such bond does not contain any such provisions for the payment of the claims of persons furnishing labor or material under said contract, such bond shall nevertheless inure to the benefit of such person furnishing labor or material under said contract, the same as if such stipulation had been incorporated in said bond; and any such person who has furnished labor or materials used therein, for which payment has not been made, shall

have the rights to intervene and be made a party to any action instituted on such bond, and to have his rights adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the rights or claim for damages or otherwise, of the obligee."

The Natchez Investment Company filed suit (R. 1) in one of the Chancery Courts of Mississippi against J. V. & R. T. Burkes as contractors, the appellant, Hartford Accident & Indemnity Company as surety on the contractor's bond, and a number of materialmen, alleged to have claims against the complainant under the statute above referred to, and the New Orleans Bank and Trust Company, to whom it is alleged the contractors had assigned a part of the purchase price. The complaint set out that the complainant had contracted with the contractors for the erection of a hotel—the contract being attached as an exhibit and made a part of the complaint (R. 10-17); that the contractors gave the complainant a bond with the present appellant as surety thereon—a copy of the bond being also attached as an exhibit and made a part of the complaint (R. 17-20); that it had received notice from various other defendants that they had furnished materials in the construction of the hotel and had not been paid by the contractors; that they had been notified by the New Orleans Bank that the contractors had assigned to it a large portion of the contract price and that unless the bond exhibited as a part of the complaint be held to be such a bond as to satisfy the requirements of the statute above referred to, the assignment to the bank was void.

The complainant prayed that the bond be held to be such a bond as is provided for in the statute aforesaid; that the validity of the assignment to the New Orleans Bank be determined; that materialmen claiming liens should be required to assert them in the action and for the adjustment of all equities between the parties. (R. 9.)

The present appellant, the surety on the bond, filed its demurrer (R. 39) making the points:

(1) That the bond showed on its face that it was not such a bond as the statute contemplates;

(2) And that it did not guarantee faithful performance of the contract within the meaning of the statute;

(3) That if the bond should be construed as coming within the terms of the statute, then that law itself is void as an unwarranted interference with the freedom of contract as against the landowner, the contractor and the contractor's surety, and, therefore, violates the "due-process-of-law clause" of the 14th Amendment of the Constitution of the United States.

(4) That the statute further violates the same provision of the Constitution insofar as it prohibits assignment of the purchase price by the contractor, in that it is an unwarranted interference with the freedom of contract.

(5) That it is not within the power of the legislature of Mississippi to create a contract between persons sui juris;

(6) And that so to construe the law would constitute the taking of property without due process of law in violation of said clause of the Constitution.

(7) That the section of the law (§ 3) which requires that the contractor's bond when given at the instance of the owner shall protect third persons not named in the bond is unconstitutional and void in that it is an attempt by the legislature to

(a) make a contract between persons without their consent;

(b) give a class of third persons rights without the consent of the parties to the contract, and thereby constituting an absolute infringement of the freedom of contract;

(8) And therefore said statute violates the aforesaid provision of the Constitution;

(9) And that it is not within the police power of said State to pass such an Act.

The demurrer was overruled and appeal taken to the Supreme Court of Mississippi. (R. 41.)

The Supreme Court on this interlocutory appeal held (R. 46) (R. 54) that while the State has no such power to deal with the contracts of private persons as it has to deal with the contracts of public bodies, still it did have some power of regulation and that the statute did not go beyond constitutional limits in this respect.

In emphasizing the point that the parties had freedom of contract even as to the nature of the bond itself, the Court in its official opinion (155 Miss. 31; 119 So. 366) in quoting, in this context, the part of section 3 of the statute which refers to the nature of the statutory bond, italicises the portion as to its "containing such provisions and penalties as the parties thereto may assert therein"—though in printing this opinion in the transcript in this case (R. 55) the italics are not shown.

The Court then held that the bond in the record was such a bond as came within the provisions of the statute.

The case having been remanded for further trial (R. 57), a decree was had in the Chancery Court (R. 57) finding against any right of the original complainant to recover, but awarding judgments against the present appellant in favor of the various materialmen; and the surety company again appealed.

The further proceedings in the case after the decision by the Supreme Court of Mississippi that the statute was not vio-

lative of the U. S. Constitution are not material to a decision of the questions presented in the appeal; except insofar as they show a final judgment against the appellant and except insofar as the subsequent decisions by the Supreme Court in the case disclose the construction, range and effect which that Court, as the highest court of the State, gives to the statute; but are material for these purposes.

So far as the first opinion discloses, it was left open to the appellant to enforce the provisions in the bond and to rely upon the breach of conditions therein as a defense against liability, except the provision that no right of action on the bond should accrue for the benefit of anyone other than the obligee named therein. The judgment overruling the demurrer of legal necessity, negatived the right to enforce this term of the contract. From the opinion in the second appeal (R. 67) it appears that the bond had been so breached by the obligee in various respects as to render it void, under its written terms and conditions; but the Court held (R. 72) that when the bond was given the statute wrote into it the statutory obligation in favor of materialmen and that none of the provisions of the bond in conflict wherewith could be given effect (R. bottom p. 72).

Final judgment and decree of the Supreme Court of Mississippi was rendered in accordance with the opinion just stated. (R. 74.)

The present appellant filed what is called, in the Mississippi practice, a suggestion of error.

In this suggestion of error (R. 83) the Federal constitutional questions were again presented in view of the broader construction given to the statute by the Court in its second opinion. The suggestion of error was entertained by the Court; and, after a discussion of the constitutional questions, was overruled (R. 90). In connection with the overruling of the suggestion of

error, the Court rendered its third opinion (R. 86), reiterating (R. 88) its prior holding that "while parties have a constitutional right to make private contracts, and to embody in them such stipulations as they desire, yet the legislature may provide rights, under law, for materialmen and laborers which private contracts cannot displace."

The appeal to this Court was thereupon perfected.

SPECIFICATION OF SUCH OF THE ASSIGNED ERRORS AS ARE INTENDED TO BE URGED.

1. That the Supreme Court of Mississippi erred in holding and deciding that the statute of Mississippi, approved March 28, 1918, known and designated as Chapter 128, Laws of Mississippi of 1918, [Hemingway's Code (1927) of Mississippi, Sections 2596 to 2603, both inclusive] upon which the decision against said Hartford Accident & Indemnity Company is based and upon which liability against it is predicated is not invalid as being repugnant to the Constitution of the United States, as being a law of said State which deprives persons upon whom it operates of liberty and property without due process of law.

2. That the Supreme Court of Mississippi erred in holding and deciding that Section 3 of said statute of the State of Mississippi, as construed and applied by the Supreme Court of Mississippi, in its decision and judgment in this suit, is not repugnant to the Fourteenth Amendment to the Constitution of the United States, and, therefore, void in that it deprives the appellant of property and a property right without the process of law.

3. That the Supreme Court of Mississippi erred in holding and deciding that said statute of the State of Mississippi, and particularly Section 3 thereof, is not repugnant to the Four-

teenth Amendment of the Constitution of the United States as depriving the appellant, Hartford Accident & Indemnity Company and the landowner, Natchez Investment Company, Inc., of a property right, to-wit: the liberty of contract, without due process of law. To make this assignment of error more specific it is pointed out that the Supreme Court of Mississippi construed and applied said statute in this case, where the said appellant, as surety, entered into a bond with the said landowner, as obligee, providing that if said surety's principal, who was a contractor for the erection of a building for said landowner, "shall indemnify the obligee against loss or damage directly caused by the failure of the principal faithfully to perform the contract" the bond should be void and the bond further provided that it should not "apply to nor cover guarantees . . . for the furnishing of any bond" under the contract between the landowner and the contractor," and the bond further provided that "no right of action shall accrue upon or by reason hereof to or for the use or benefit of any one other than the obligee named therein," by a holding that under said statute said bond was also subject to the additional obligation prescribed by said statute "that such contractor shall promptly make payments to all persons furnishing labor or material under said contract," and that the bond would inure to the benefit of material men and that breaches of its conditions by the obligor would not be a defense by the surety against the claims of said materialmen. It is further pointed out that the Supreme Court of Mississippi thus construed and applied said statute with the effect of making it deprive said appellant and said landowner of the liberty of contracting for the indemnifying of said landowner against loss or damage directly caused by the failure of the contractor to perform the contract without also giving materialmen, furnishing material to the contractor, a right of action in the bond for the value of their materials furnished, despite the contractual provisions of the bond to the contrary.

4. Because the Supreme Court of Mississippi erred in affirming the judgment of the Chancellor sitting in the Chancery Court of Adams County, Mississippi, in overruling the demurrer of the Hartford Accident & Indemnity Company to the original bill in said cause; and particularly the second, fourth, fifth, sixth, eighth and ninth grounds of said demurrer which assert the repugnancy of said statute to the Constitution of the United States.

5. Because the Supreme Court of Mississippi erred in affirming the judgment and decree of the Chancellor sitting in said suit in the Chancery Court of Adams County, Mississippi, and in rendering judgment and decree in favor of materialmen and against said appellant, Hartford Accident & Indemnity Company, on said bond.

6. That the Supreme Court of Mississippi erred in holding and deciding that said statute of the State of Mississippi which, as construed by the Supreme Court of Mississippi, deprived the appellant, as surety on a bond, of the liberty of contracting that its liability as surety should extend only to the indemnification of the obligee (a landowner, having private work done for him), against loss or damage directly caused by the failure of the contractor faithfully to perform the contract and that no other person should have a right of action in the bond, is not void for its repugnance to the Fourteenth Amendment to the Constitution of the United States.

7. That the Supreme Court of Mississippi erred in holding and deciding that the Legislature of Mississippi had the power to enact said statute under the police power of said State.

ARGUMENT

SUMMARY

1. This Court will determine the constitutionality of the statute not on its literal words alone, but upon the construction and effect given it by the highest court of the State of Mississippi. The statute attacked is unconstitutional on its face; but especially so under the construction given it by the state court.

2. The decisions of the Supreme Court of Mississippi in this case, construing the statute, will themselves be construed together and will be interpreted in the light of the facts to which the language of the opinions relate.

3. It was necessary for the Court to construe the statute to determine whether the bond in the case was such a bond as fell within the purview of the statute.

4. The bond did not purport to follow the statute by "guaranteeing the faithful performance of the contract," but only to give to the obligee a modicum of indemnity against direct loss and damage and to give this only on certain express conditions or contingencies; and the bond expressly provided that no right of action should accrue on it to or for the benefit of any one other than the named obligee.

5. The Supreme Court of Mississippi, in its first opinion, construed the statute as extending to such a bond.

6. On the second appeal, the Court held that despite the fact that the parties were at liberty to insert in the bond such provisions and conditions as they saw fit, the statute prevented any force or effect being given to any such provisions or conditions

insofar as they defeat the right of materialmen to have a full, unconditional right of action on the bond.

7. The effect of the three decisions is that the statute under attack has the effect of preventing a landowner and a surety company from contracting for the conditional indemnification of the landowner against direct loss and damage under a building contract unless the parties are also willing to agree that third persons (the materialmen) may also have an unconditional right of action on the bond for debts due them by the contractor; even though the parties expressly agree as one of the conditions on which the surety assumes liability, that such third persons shall have no rights under the contract.

8. As thus construed, the statute abridges the liberty of the landowner of contracting for his own personal indemnification in a purely private matter; and abridges the liberty of the surety of contracting to give that indemnification on terms mutually satisfactory to the surety and the landowner.

9. It gives to third persons contractual rights, superior to those of the parties themselves, in a purely private contract, without the assent or consent of the parties thereto and against the express terms of the contract as consented to by the original parties.

10. The case involves no question as to how far a State may regulate the business of corporate suretyship.

11. The validity of the statute insofar as it merely creates a lien in favor of materialmen is not involved in the case.

12. The right to contract as to one's own affairs is the part of the liberty protected by the due-process-of-law clause of the Constitution; and statutes materially and arbitrarily affecting this liberty are void.

13. The jurisdiction of this Court over the constitutional questions is complete, since the action was based on the statute attacked and the constitutionality of the statute was raised by demurrer. In such cases this Court will put its own interpretation on the bond and the bill of complaint; and is bound by the decisions of the State Court only as to the construction it has put on the statute in applying it to the admitted facts presented.

It is axiomatic that this Court, in determining the constitutionality of a State statute, will not look alone to the words of the statute, but will narrow or broaden its meaning and practical effect accordingly as the highest Court of the State has construed it and applied it. If the attack be made for violation of the due-process-of-law clause of the Constitution, this Court will uphold the statute, even though on its face it appears to violate the constitutional provision, if the State Court has so construed it and applied it as to eliminate the offending features of it. On the other hand, though the statute be fair on its face, or if it be so worded as that it might be construed and applied either in a constitutional way or in an unconstitutional way, and the highest court of the State, having the statute before it for construction and application, construes it and applies it in such a way as to introduce into it an element, which would make it, as thus construed and applied, deprive any person of life, liberty or property without due process of law, this Court must invalidate it, even though as an original proposition, this Court would not give it any such construction or effect.

Supreme Lodge v. Meyer, 265 U. S. 30; 68 L. ed. 885.

Near v. Minnesota, 283 U. S. 697; 75 L. ed. 1357.

Even on its face the statute appears to be unconstitutional. For the legislature to say that if a contractor, making a contract

with a private person, for work of a non-public nature, enters into a bond with such person guaranteeing the performance of his contract, he must insert into the bond an obligation in favor of third persons, even though such third persons be his prospective creditors, or the law will insert the additional obligation, seems to be an unconstitutional interference with the liberty of contract. However, the construction given by the state court to the statute makes it go so much further in this direction that this phase of the case may be left with the mere mention of it.

The decisions of the Supreme Court of Mississippi, insofar as they construe and apply the statute in question, must themselves be construed and interpreted in connection with the factual elements to which the language used in them applies. In simpler words, we mean to say that to understand the meaning and effect of these decisions, we must read them in connection with the facts (including the bond itself, as one of the facts) with which they were dealing, and in connection with the questions presented by the record before the court at the time of the various decisions.

Furthermore, we think we are reasoning soundly when we assert that, while it is in the last two decisions that the Court most clearly gives to the statute the interpretation and effect which, from our point of view, renders it repugnant to the Constitution, still it is by the construction given to the statute by the Mississippi court in these last decisions, as well as in the first one, that this Court will determine its scope and constitutional validity, even in passing on assignments of error relating to rulings on the demurrer which raised the questions of its constitutionality and which was the subject of the first appeal, and, therefore, of the first decision. In passing, however, we may note that these constitutional questions were again presented to the Court by the suggestion of error which the Court

entertained, discussed and overruled; and this we understand is sufficient of itself to give this Court jurisdiction over these questions as applied to the whole case.

Mallet v. North Carolina, 181 U. S. 589; 45 L. ed. 1015.

Leigh v. Green, 193 U. S. 79; 48 L. ed. 623.

Brinkerhoff-Faris Trust Co. v. Hill, 281 U. S. 673; 74 L. ed. 1107.

It is only fair to the Mississippi court to read all three of the opinions together, as if they were a single opinion, especially since in the last opinion that Court so declares. (R. middle of p. 88.)

So let us look at the decisions in this light.

Reading the bond in this case and reading the statutes, it is perfectly plain that the landowner and the surety company undertook to make a special contract for the indemnification of the landowner in such a way as to give the landowner a modicum of protection, on certain clearly expressed terms and conditions, and in such a way as not to subject the surety to the enlarged liability imposed by the statute.

For example, the statute speaks of a bond "guaranteeing the faithful performance of such contract." The condition of the bond in the record (R. 18) is that "the principal shall *indemnify* the obligee against loss or damage directly caused by the failure of the principal faithfully to perform the contract"—two very different things both in law and in fact; and even this indemnity was itself not absolute, but was conditioned upon certain clearly defined contingencies.

We shall not overlook the fact that the Supreme Court of Mississippi in its opinions (R. 56, R. 87) laid great stress upon

the fact that the bond on its face recites that "whereas the principal and the obligee have entered into a certain written contract . . . to construct Eola Hotel building . . . a copy of which is or may be attached hereto, and is hereby referred to and made a part hereof;" and that in the contract thus referred to there is a provision (Article 30, R. 16) that it shall be the obligation of the contractor to include within his bid the furnishing of a bond conditioned as the law of Mississippi requires and that this bond shall protect *the owner* against all liens or claims against the building according to the laws of the State of Mississippi; and another provision (R. 17) that the contractor's bondsmen shall obligate themselves to all the terms and covenants of specifications and of the contracts covering the work; though in another portion of the contract to which the Supreme Court of Mississippi made no reference (R. 15) the landowner reserved the right to vary the form of this bond. Reading the bond and the contract together, it is most manifest that the parties were studiously attempting to draw a special contract which would not impose on the surety the liability imposed in § 3 of the statute.

As later shown in this brief, this Court will construe the contract for itself, and is not bound by the construction of the State Court.

However, no matter how fully we may consider these provisions and every other provision of the contract between the contractor and the landowner as being incorporated into the bond in the part of it where the reference to this contract is made, nevertheless there is no escape from the fact that the written contract between the landowner and the surety, as expressed in the bond, did not stop at this point; for the language referring to the contract between the contractor and the surety is immediately followed by stating the conditions which attach to the obligations of the bond (not merely the obligation to pay

the penal sum of the bond, $316,812, but also such obligation as the surety may have assumed by the reference to the underlying contract) and on the happening of which the bond should be void. (R. 18.)

In addition to the main condition that the bond should be void if the principal should indemnify the owner against loss or damage directly caused by the failure of the principal faithfully to perform his contract, certain other express conditions precedent to liability on the part of the surety were inserted. Among these conditions were:

(a) that the obligee should at all times and in the manner specified in the contract comply with his obligations assumed under the contract (R. 18);

(b) that notice should be immediately given the surety of any default on the contractor's part, with right on the surety's part to take over the contract and complete it (R. 18).

(c) that if there came to the [illegible]ce or knowledge of the obligee that there was any [illegible]laim against the contractor for unpaid labor or material, the obligee should not make any further payments to the contractor until such claims were satisfied. (R. 19.)

(d) that the bond should not cover any guarantee in the contract "for the furnishing of any bond" (R. 19, bottom page). (It may be seen that if the reference earlier made in the bond to the underlying contract had the prima facie effect of writing into the bond the provision as to giving any bond, this express condition had the effect of excluding it); and

(e) that payments to the contractor should be made in cash only (R. 20, ¶ 7 of the conditions);

(f) that "no right of action shall accrue upon or by reason hereof, to or for the benefit of any one other than the obligee named herein." (R. 20.)

The contract itself provided (R. 16) against assignments of the contract price without the owner's consent.

With this bond before it, and with the statute before it, the Supreme Court of Mississippi in its opinion (R. 55, near bottom of page) asks this question: "Does the bond given in the present case come within the provisions of Section 3; in other words, is it such a bond as is provided for therein?"

This made it necessary for the Court to construe and apply the statute. If it answered the question in the negative, the surety's demurrer was well taken; and the New Orleans Bank's assignment of the contract money was invalid, under § 2 of the Act. If it answered the question in the affirmative, it exposed the statute to the constitutional attack also made in the demurrer; but left the Bank's assignment of the funds valid. The Court had already quoted and underscored the portions of § 3 of the statute, that the prescribed bond could contain "such provisions and penalties as the parties thereto may assert therein." It thereupon held that the bond in the record was such a bond as the statute contemplated and that the bank's assignment of the funds was good.

The effect of this decision was to construe the statute as not requiring an unconditional bond and as including within its purview a bond such as the one before it, even though one of the conditions in it was that no right of action on it should accrue in favor of or for the use of any materialmen, and though there were other provisions in it which rendered liability on it wholly conditional. It might have been more logical for the

Court to construe the statute as requiring an unconditional bond; but the Court did not so construe it.

The State Court in its first opinion (R. 54, 55) seems to assume that the constitutional objections to the statute is answered by the holding that the landowner has free choice between giving the bond and allowing the funds in his hands to become subject to the statutory lien—that the statute did not compel the landowner to take any bond at all. This construction of the statute (that section 3 of the Act insofar as it provides for the taking of a bond is not mandatory on the landowner) would have had the effect of avoiding the point that it would be violative of the Constitution to require mandatorily that a landowner give a bond to protect materialmen, if any such point had been made. But that is not the point at all.

The constitutional point raised in the record, on both the appeals, is that while the landowner has the choice under the statute of taking no bond (though a failure to do so impounds the funds in his hands to the extent stated in the statute) or of taking a bond which will give a right of action also to the materialmen, the statute denies him the liberty of taking a bond for his own immediate protection (though he is willing to have the funds impounded, if occasion therefor should arise) unless he also takes a bond for the benefit of the materialmen; also, that it denies a surety, who, as in the case at bar, is willing to indemnify a landowner against direct loss or damage from the contractor's failure to perform the contract, but is unwilling to assume any obligations to materialmen, from so contracting with his obligee as to escape this added liability and increase of risk.

Nor can the questions involved be fully grasped unless we keep in mind that, under the statute, in the absence of a bond, the rights of materialmen are limited to that portion of the

contract price which is unpaid at the time notice is given of their claims, but that if a bond be given the liability to materialmen is not limited even to the total contract price, but only by the amount of the claims themselves, whatever that amount may be.

The point was squarely made that if the statute were so construed as to include within its purview—and especially within the purview of that portion of Section 3 which provides that though the parties omit from the bond the additional obligation in favor of the materialmen, the bond shall nevertheless inure to their benefit "the same as if such stipulations had been incorporated in said bond," and gives the materialmen a corresponding right of action on the bond—a bond, such as the one in the case at bar, wherein the additional obligation was not only omitted, but wherein there was an express condition that it should not inure to the benefit of materialmen, the statute was unconstitutional for its abridgement of the liberty of contract.

Without discussion, the Court, in its first opinion, merely decided against the constitutional attack on this ground, by an affirmance of the Chancellor's decree overruling the demurrer which presented this question.

How far the Court had gone in construcing this provision of the statute as to the additional obligation of materialmen did not definitely appear until the Court had the case before it on the second appeal. The facts then presented made it necessary to give further construction to this provision of the statute. The bond was plainly conditional on its face. Even if the parties had written into it the obligation in favor of the materialmen, in the same place in the bond and in the same context as the obligation in favor of the landowner was written, still both of these obligations would have been followed by the express con-

ditions which were in terms made conditions precedent to any liability under the bond. As shown in the statement of facts prefacing the second opinion (R. 67-70), the conditions on which the surety was to be held liable were broken in a number of respects (though for present purposes it is sufficient to state only one—that the owner paid the contractor in notes instead of cash; a violation of the seventh condition of the bond) (R. 20). No recovery could be had on the bond unless the Court held that these conditions could be read out of it as the result of legislative fiat.

The Court then held (R. 72) that the statute prohibited the parties to the bond from entering into any stipulation which would affect the statutory obligation. Or as the Court put it, in passing on the suggestion of error, with reargument of the constitutional questions (R. 84-86): "While the parties have a constitutional right to make private contracts and to embody in them such stipulations as they desire, yet the legislature may provide rights, under law, for materialmen and laborers which private contracts cannot displace."

Here we have a construction of the statute which squarely presents one of the constitutional question we are making. For the two decisions taken together mean and must mean that while the parties to the contract are allowed perfect freedom as to what they will agree on and insert into the contract between them, as expressed in the bond, the statute nevertheless prohibits the giving of any effect to such provisions.

It seems to us idle to speak of "freedom of contracting," when the only freedom is to allow the parties to agree on contractual relationships as a mere matter of writing them down, with the statute nullifying the effect of them as soon as they are written down.

When the three decisions are construed together, we have before us the plain, simple holding of the Supreme Court of Mississippi, that the statute under attack in this case is to be construed as preventing a landowner and a surety from contracting for the conditional indemnification of the landowner against direct loss under a binding contract unless the parties also are willing to agree that the surety on this conditional bond by which this modicum of indemnity is secured shall also be liable to certain third persons (the materialmen) whose right of action on it shall be absolute and not subject to the conditions the parties have agreed on. The statute is also construed as prohibiting the surety from contracting to indemnify the landowner only; even though in express terms, and as a part of the very contract by which the surety's liability is assumed and is to be measured, it is expressly provided that it shall not inure to the benefit of any one except the landowner.

The practical effect of such a construction of the statute is well illustrated by the ruthless disregard of private rights which the facts of this case present. What is called the bond in this case is in form a bond, but it is more than that; it is a special contract. There is a manifest practical difference, to landowner, to contractor and to surety, between a special contract (though in form of a bond) which merely conditionally indemnifies the landowner against direct loss and a bond which also unconditionally assumes liabilities to materialmen—unknown and undisclosed at the time the contract of suretyship is entered into, and unlimited in amount. The premium to be paid by the landowner and the risk of the surety are wholly different. The number of contractors who can give bonds in large sums for the protection of materialmen is comparatively small; since the chief element here to be considered is financial responsibility. The number of contractors who can give bond only for the owner's protection against failure to complete the

contract is much larger; for here the contractor's personal skill and his reputation for honesty are more controlling; especially where the surety on the bond reserves the right to complete, if the contractor fails; and payments are to be withheld except as the work progresses. Hence, when the owner requires only the latter form of bond, the number of contractors who can bid is materially increased, and the landowner gets the benefit of the competition and a lessening of the contract price.

Under the bond, as written in this case, the surety's risk was comparatively small, until it was extended by statutory fiat; and yet a comprehensive plan for the protection of all parties was specially agreed on in the terms set out in it. If the landowner paid the contractor only as the work progressed, and paid only in cash so that the contractor would be able to pay his bills for labor and materials promptly; and if, on notice of any such unpaid claim as would create a lien against the landowner or his property, the landowner should hold up the balance of the contract price; and if, as provided in the contract, the contract price could not be assigned, and the surety had the right to come in and complete the work, upon failure of the contractor, with right to receive the balance of the contract price so far as necessary to reimburse itself—if this plan set out in the bond and contract had been pursued, the surety's risk was small. Nor would any rights of materialmen under § 1 of the statute in question have been prejudiced, for their lien on the funds extends only to the balance due the contractor at the time the notice is given the landowner; and the bond provides that the landowner, upon receipt of such notice, should hold up the balance due the contractor.

And yet the surety in this case, which was so careful to limit its liability to the risk just indicated, is, as a result of the construction and application of the statute, confronted with an adjudged liability of some $75,000; notwithstanding the land-

owner with whom the surety contracted began almost as soon as the bond was signed to violate its provisions, to make payment in its notes instead of cash, to consent to assignments of the contract price, to fail to hold up the contractor's money after notice of claims, etc.

Also upon the authority of the statute attacked, the Supreme Court of Mississippi has held this surety to be liable to those to whom it contracted not to be liable, and has held that the statute also prevents it from asserting in defense of its liability the very conditions on which it consented to assume liability at all.

A statute which includes within its purview any such effect certainly deprives the parties of liberty of contracting. Our contention is that the denial of the right to contract in these respects is arbitrary and beyond the power of the State.

In passing, we may notice another matter to exclude it from the argument. While the surety in this case is a corporate surety—an insurance company—the case involves no question as to how far a State may regulate the contracts of corporate sureties or insurance companies. The statute in question does not relate to corporate surety business. It affects private and corporate sureties alike.

Nor is the validity of the statute, insofar as it creates a lien in favor of materialmen, in question.

To provide, as this statute in its first and second sections provides, for an automatic lien on funds due the contractor, in the nature of a garnishment in favor of materialmen, upon notice given the landowner, is neither arbitrary or unreasonable, though the freedom of contracting between the landowner and the contractor may in a sense be abridged. For the landowner

would not be called on to pay more than he contracted to pay. The statute in this respect has merely provided convenient machinery for applying the funds of the contractor to the payment of his debts. Natural equities in favor of the materialmen, as creditors of the contractor, give reason and constitutional validity to such a provision.

But far different it is for the statute to say that the landowner cannot exercise his constitutional liberty of protecting himself against direct loss on account of the contractor's failing to perform the contract, unless he and the person willing to furnish this special and personal indemnity also so contract as that the surety shall be unconditionally liable to the materialmen, whether their claims exceed the contract price or not. And still further different it is for the statute (as construed by the court) to say that whenever the landowner and a surety make such a special contract of indemnity and expressly agree that they and they alone shall be parties to it and entitled to its benefits, the law will nevertheless, without their consent and over the express terms of the contract, insert into the contract an obligation in favor of the materialmen, thus making a conditional promise to indemnify the landowner an unconditional promise to pay third persons.

Courts cannot make contracts for persons sui juris (*Cheney v. Libby*, 134 U. S. 68; 33 L. ed. 818); nor can the legislature do so without violating the liberty guaranteed by the Fourteenth Amendment of the Constitution.

The fact that the liberty of contracting is impaired by indirection instead of by direct means is immaterial. For a statute to prevent the terms of a contract from being enforced according to their natural tenor and effect is violative of the Fourteenth Amendment of the Constitution, though the prohibition of the statute operates indirectly rather than directly.

New York Life Insurance Co. v. Dodge, 246 U. S. 357, 377; 62 L. ed. 772, 783.

The right to contract as to one's own affairs is a part of the liberty protected by the due-process-of-law clause of the Constitution.

On this point we feel that we need only cite

Adkins v. Children's Hospital, 261 U. S. 525; 67 L. ed. 785.

For in that case the prior authorities are fully collected and discussed. The exceptional cases in which liberty of contract can be abridged are also set forth and distinguished.

As was said by the Court of the law then before it, so also it is true of the statute herein attacked, "It is not a law dealing with any business charged with a public interest, or with public work, or to meet and tide over a temporary emergency. . . . It is not for the protection of persons under legal disability, or for the prevention of fraud."

See also *Mayer v. Nebraska*, 262 U. S. 390; 67 L. ed. 1042.

The state courts have usually held such provisions as are contained in the Mississippi statute void.

Gibbs v. Tally, 133 Cal. 373; 65 Pac. 970.

Montague v. Furness, 145 Cal. 205; 78 Pac. 640.

Williams v. Baldwin (Tex.) 228 S. W. 554.

Hess v. Denham L. Co. (Tex.) 218 S. W. 162

Stinson Mill Co. v. Braun, 136 Cal. 122; 57 L. R. A. 726.

Kelly v. Johnson, 251 Ill. 135; 95 N. E. 1068; 36 L. R. A. (N. S.) 573.

State statutes which so materially abridge the liberties of private persons in contracting as to their private affairs are violative of the Fourteenth Amendment of the Constitution.

Tyson v. Banton, 273 U. S. 418; 71 L. ed. 718.

Ribnick v. McBride, 277 U. S. 350; 72 L. ed. 913.

Woolf v. Industrial Court, 262 U. S. 522; 67 L. ed. 1103.

Smith v. Cahoon, 283 U. S. 553; 75 L. ed. 1264.

The building of a private structure is a purely private matter, affected with no public use or interest. Materialmen are in no true sense wards of the State; though through the powerful lobbies which their associations maintain they have made strenuous efforts in various States to have themselves treated as if they were, and have succeeded in a number of States in having statutes passed to give them special privileges. A part of the present nationwide depression may well be traced to the effect of some of these statutes—none of which, so far as we have observed, goes quite as far as the Mississippi statute in infringing private rights of landowners—since the inability of so many otherwise eligible contractors to give surety bonds has increased the cost of construction to where landowners are unwilling to contract for the erection of buildings. If there be a public interest involved in the subject-matter, it is not on that side of the question which would uphold this statute.

In conclusion: The jurisdiction of this Court to pass upon the question whether the attacked statute is void because violative of the U. S. Constitution cannot be successfully challenged on any suggestion that the decision of the Supreme Court of Mississippi can be supported on any non-federal ground.

The defendant (now appellant) raised the question of the repugnancy of the State statute to the United States Constitution at the threshold of the case by demurrer to the original bill of complaint; the grounds of demurrer being in substance that no action could be maintained, under the statute, on the bond, because the statute was unconstitutional (R. 17). There is nowhere in the record any suggestion of liability on the bond, otherwise than under the statute. The Supreme Court of Mississippi necessarily based its judgment against the appellant on its construction of the statute and by applying the statute as thus construed to the bond. Under the pleadings, the Court did not and could not decide the case adversely to the appellant without deciding adversely to the contention of the appellant made in the demurrer, and in the suggestion of error, that the statute was unconstitutional.

St. Louis & I. M. R. Co. v. Starbird, 243 U. S. 592; 61 L. ed. 917.

The constitutional question having arisen by demurrer, the ordinary rule, that this Court accepts as final the conclusion of facts made by the state court, does not apply. The only thing binding on this Court is the state court's construction of its statute.

Truax v. Corrigan, 257 U. S. 312; 66 L. ed. 254, and cases therein cited.

Fiske v. Kansas, 274 U. S. 380; 71 L. ed. 1108.

Appleby v. New York, 271 U. S. 364; 70 L. ed. 992.

"It is well understood that, when the jurisdiction of this court is invoked to determine whether a state law impairs the rights of the litigant under a prior contract, or whether

the State is depriving him of his property without due process of law in violation of the Fourteenth Amendment, and the question turns upon the existence or terms of a contract, this court is bound to determine for itself whether there is a contract and to ascertain its true meaning and effect. That rule is necessary in order that this court may properly enforce these provisions of the Constitution.

Railroad Commission v. Eastern Texas R. Co., 264 U. S. 79, 86, 68 L. ed. 569, 572, 44 S. Ct. 247 and cases cited."

Coolidge v. Long, 282 U. S. 582, 75 L. ed. 562.

"When a party appeals to this court for the protection of rights secured to him by the Federal Constitution, the decision is not to depend upon the form of the state law, nor even upon its declared purposes, but rather upon its operation and effect as applied and enforced by the State; and upon these matters this court cannot, in the proper performance of its duty, yield its judgment to that of the state court."

Coppage v. Kansas, 236 U. S. 1, 15; 59 L. ed. 441, 446.

Respectfully submitted,

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APPENDIX

AN ACT to amend Section 3074 of the Mississippi code of 1906, and to enlarge the rights conferred therein upon materialmen, subcontractors, laborers and journeymen; to prohibit assignments, transfers, or other dispositions in derogation of the rights hereunder created; to make said rights concurrent; to provide that laborers, subcontractors, materialmen and journeymen shall be protected under contractor's bonds and may sue thereon.

SECTION 1. Be it enacted by the Legislature of the State of Mississippi, That Section 3074 of the Mississippi code of 1906 be amended so as to read as follows:

"3074. (2714) *Subcontractors, laborers, etc., may bind the amount due the contractor by written notice.* (Laws 1904, chapter 153.) When any contractor or master workman shall not pay any person who may have furnished materials used in the erection, construction, alteration, or repair of any house, building, structure, fixture, boat, water craft, railroad, railroad embankment, or the amount due by him, to any subcontractor therein, or the wages of any journeyman or laborer employed by him therein, any such person, subcontractor, journeyman or laborer may give notice in writing to the owner thereof of the amount due him and claim the benefit of this section; and, thereupon the amount that may be due upon the date of the service of such notice by such owner to the contractor or master workman, shall be bound in the hands of such owner for the payment in full, or if insufficient then pro rata, of all sums due such person, subcontractors, journeymen and laborers, who might lawfully have given notice to said owner hereunder, and, if after such notice, the contractor or master workman shall bring suit against the owner, the latter may pay into court, the amount due on the contract; and thereupon all persons entitled hereunder, so far as known, shall be made parties and summoned into

court to protect their rights, contest the demands of such contractor or master workmen and other claimants; and the court shall cause an issue to be made up and tried and direct the payment of the amount found due in accordance with the provisions hereof; or in case any person entitled to the benefits hereof, shall sue the contractor or master workman, such person so suing shall make the owner and all other persons interested, either as contractors, master workmen, subcontractors, laborers, journeymen or materialmen, so far as known, parties to the suit (and any such party if not made a party in any suit hereunder authorized may intervene by petition), and, thereupon the owner may pay into the court the amount admitted to be due on the contract or sufficient to pay the sums claimed, and the court shall cause an issue to be made up and award the same to the person lawfully entitled; in either case the owner shall not be liable for costs; but if the owner, when sued, with the contractor or master workmen, shall deny any indebtedness sufficient to satisfy the sums claimed and all costs, the court shall, at the instance of any party interested, cause an issue to be made up to ascertain the true amount of such indebtedness and shall give judgment and award costs according to the rights of the several parties in accordance herewith. In case judgment shall be given against such owner, such judgment shall be a lien, from the date of the original notice, and shall be enforced as other liens provided in this chapter. The owner shall not be liable in any event for a greater amount than the amount contracted for with the contractor.

Assignments by Contractor prohibited.

Sec. 2. No contractor or master workman except as hereinafter provided, shall have the right to assign, transfer, or otherwise dispose of in any way, the contract or the proceeds thereof, to the detriment or prejudice of the subcontractors, journeymen, laborers, and materialmen as declared hereinbefore and all such assignments, transfers, or dispositions shall be subordinate to the said rights of the subcontractors, journeymen, laborers and materialmen, as well as the owner. Provided, however, that this section

shall not apply to any contract or agreement where the contractor or the master workman shall enter into a solvent bond conditioned as provided for in section 3 hereof.

Bond to pay for labor and materials furnished.

Sec. 3. That when any contractor or subcontractor entering into a formal contract with any person, firm or corporation, for the construction of any building or work or the doing of any repairs, shall enter into a bond with such person, firm or corporation guaranteeing the faithful performance of such contract and containing such provisions and penalties as the parties thereto may insert therein, such bond shall also be subject to the additional obligations that such contractor or subcontractor, shall promptly make payments to all persons furnishing labor or material under said contract; and in the event such bond does not contain any such provisions for the payment of the claims of persons furnishing labor or material under said contract, such bond shall nevertheless inure to the benefit of such person furnishing labor or material under said contract, the same as if such stipulation had been incorporated in said bond; and any such person who has furnished labor or materials used therein for which payment has not been made, shall have the rights to intervene and be made a party to any action instituted on such bond, and to have his rights adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the rights or claim for damages or otherwise, of the obligee. If the full amount of the liability of the surety thereon is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the obligee, the remainder shall be distributed pro rata among said intervenors. The bond herein provided for may be made by any surety company authorized to do business in the state of Mississippi.

Bond—right of action—by whom.

Sec. 4. If no suit shall be brought by the obligee within six months from the completion and final settlement of said contract, then any person supplying therein labor or materials shall have a right of action on said bond for his

use and benefit against said contractors and the sureties thereon and to prosecute same to final judgment and execution, subject to the rights and demands of the owner.

Bond—suit on—when instituted.

Sec. 5. When suit is instituted by any such person on a bond, it shall not be commenced until after the complete performance of said contract, and final settlement thereof, and shall be commenced within one year after the performance and final settlement of said contract and not later; provided that if the contractor quits or abandons the contract before its completion suit may be instituted by any such person including the owner on said bond and shall be commenced within one year after such abandonment and not later. But said period for the limitation of the institution of said action shall not begin to run until the obligee shall have made said final settlement or determined said abandonment and published notice thereof in some newspaper in said county, or if there be none then in some newspaper having a general circulation therein.

Bond—suit on—only one action.

Sec. 6. When suit is so instituted by any person only one action shall be brought and any person entitled to sue may upon application intervene and be made a party to said suit; however, such intervention must occur within the time limited for such person to bring an original action.

Judgment on bond—funds insufficient—pro rata recovery.

Sec. 7. If the recovery on the bond should be inadequate to pay the full amount found due including amounts due the owner, judgment shall be given after the obligee is fully satisfied for all claims, demands, rights, and damages to each person pro rata of the amount of the recovery. The sureties on said bond may pay into court for distribution the full amount of their liability less any amount which may have been paid to the obligee by reason of the execution of said bond, upon so doing the surety will be relieved from further liability.

Process—sec. 3064 code amended. (Hemingway code sec. 2424.)

Sec. 8. To all suits instituted under the provisions of this act the parties interested shall be summoned as provided by section 3064 of code of 1906.

Sec. 9. That this act take effect and be in force from and after its passage.

Approved March 28, 1918.